No. 14846

United States
COURT OF APPEALS
for the Ninth Circuit

LEO ELWERT,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

PETITION FOR RE-HEARING AND BRIEF IN SUPPORT THEREOF

Appeal from the United States District Court for the District of Oregon.

HONORABLE WILLIAM J. LINDBERG, Judge.

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To: UNITED STATES COURT OF APPEALS for the Ninth Circuit, and the JUDGES thereof:

Comes now Appellant Leo Elwert and presents this, his petition for a re-hearing for the reasons and on the grounds set forth in the brief submitted herewith.

BRIEF

I

Re Over-statement of Gross Income in 1949.

In considering the effect of the over-statement of $19,000.00 of gross income in the computation of the 1949 tax liability, the Court refused to give effect to this over-statement on the ground that the jury was not bound to believe that there was such an over-statement.

We respectfully submit that the Court overlooked important and conclusive evidence which removed this question from the realm of disputed fact. There was no question of credibility of the witness Hammond in this respect. The facts in this respect are all undisputed and were developed by the evidence introduced by the Government. The Court overlooked entirely the testimony of the Government's Revenue Agent Menlow in this respect. The over-statement of income was discovered by the Revenue Agent Menlow during his investigation of the case. Menlow was unable to reconcile the gross receipts for 1949 with the books and records from which accountant Hammond made up the 1949 return. (Tr. 578.) *The matter was first called to Hammond's attention* by the Revenue Agent (Tr. 325) and not by defendant's accountant Eiseman. On June 6, 1952, Revenue Agent Menlow examined Hammond under oath. Excerpts from that examination appear at pages 325 to 327 of the transcript.

Revenue Agent Menlow said to Hammond:

> "The gross receipts is nowhere in line with the bank deposits." (Tr. 326.)

Hammond then testified that that was the first time that he knew that there was an over-statement of income in the 1949 return (Tr. 327).

Hammond testified that he made up the 1949 returns from certain books and records (Exh. 49 A to C) which recorded the gross receipts insofar as they were deposited in bank accounts. It was from these books that he determined the gross income for 1949 at $175,849.00. He re-examined the *same records* in Court and that re-examination confirmed the over-statement to the extent of $19,000.00 to $20,000.00. These were the same records from which he made up the return. He arrived at that figure through "those receipt books that we are talking about." (Tr. 291-292.)

He testified that if he had the same books from which he made the return, he should be able to arrive at the same figure. (Tr. 292.) He was then asked to take those books and examine them. (Tr. 292-293-294; 298; 301.) At that point, after considerable examination, he conceded that the books he had before him were the ones from which he made the 1949 return and he testified that he was unable to reconcile the return with those books.

> "Q And the income shown upon the return is in excess of any amount that you have been able to arrive at by reconciling them with those exhibits; is that correct?

A Yes, that is right.
Q You are not able to explain that?
A No, I am not.

* * * *

Q That is possible, too. Do you know approximately, Mr. Hammond, by what amount your gross receipts reported in the 1949 return exceeded the amount that you are able to reconstruct from the books that you have?

A I think in the last time we tried to reconcile it it was approximately *twenty thousand, nineteen or twenty thousand dollars.*

Q *There was nineteen or twenty thousand dollars difference there?*

A *Yes.*" (Tr. 301-302.)

In trying to ascertain from Hammond an explanation for the over-statement of gross income, he testified as follows:

"Q Now, Mr. Hammond, if it were a fact that rather than the item of $173,319.76 as the total gross receipts from the business the gross receipts were actually $158,316.75, as is alleged to be the gross receipts by the Government for that year, could it be possible that you took into account income for that year other than income from the Tualatin Valley Nurseries operation?

A It is possible, but I would not know from what source." (Tr. 292.)

Revenue Agent Menlow testified that he made a comparison of the gross receipts shown on the unfiled 1949 return with those reflected in the books and records; (Tr. 525) and

"Q In reference to the gross receipts did you find from the books and records whether they were or were not understated or overstated?

A Yes.

Q Were they under or overstated?

A There was an overstatement but not in an amount greater than the decrease in the expenses." (Tr. 526.)

The computation of the gross income for 1949, as shown in the account book, Exhibit 49-A, B, and C (records from which Hammond made the return), *shows* that the *gross income was $19,000.00 to $20,000.00 less than the amount shown on the unfiled return.* This did not involve Hammond's veracity. It was a matter of computation. The addition of the columns of figures in the very books from which he made the return, established the fact that there was an over-statement of the gross income.

This record demonstrates that there was *no issue of fact* as to the over-statement of the income in the 1949 return to the extent of $19,000.00 to $20,000.00. The over-statement was discovered by Revenue Agent Menlow. He admitted that it was an over-statement.

The documentary evidence—the account books, Exhibit 49 A, B and C—confirms both the Revenue Agent Menlow and the accountant Hammond, that there was an over-statement of gross income. It demonstrates to a mathematical certainty that there was an over-statement in the return to the extent of $19,000.00 to $20,000.00. Bearing in mind that this is a record established as a part and parcel of the Government's case, it is impossible to conceive how there could be an issue of fact with respect to the over-statement of the gross income.

The accountant Hammond was the Government's witness and a reading of his testimony as a whole, demonstrates that *he was hostile to the defendant.* It is true that he was still keeping the accounts for the Nursery at the time of the trial, but the Court overlooked the fact that defendant was not in charge of the Nursery or was even operating it at the time. The record establishes that by reason of the marital dissension between Leo Elwert and his wife, that he was excluded from the operation of the Nursery. Hammond was maintaining the records for the Nursery under the direction of Mary Elwert and it cannot be said in any realistic sense that Hammond was Leo Elwert's accountant and favorably disposed to him.

It is true that on re-direct examination, Hammond testified that he was told by Elwert's accountant that the gross receipts in the return could not be reconciled with the books, but this was after the Revenue Agent examined Hammond about the matter. His re-cross-examination demonstrated that he already knew of the over-statement; that the facts in regard to the over-statement were developed in the written deposition that Revenue Agent Menlow took long prior to the indictment and he again conceded that there was an over-statement upon his own examination of the records thereafter and the records in evidence support the conclusion that there was an over-statement.

We respectfully submit that the Court overlooked the evidence referred to in coming to the conclusion that there was an issue of fact for submission to the jury

with respect to the over-statement of the income. This error is important because it not only wipes out the alleged under-statement of income for the year 1949, but wipes out the deficiencies in the 1947 and 1948 returns as well.

The *total income tax liability* for 1949, as computed by the Government's expert, was only $657.08 and the *additional* tax liability for 1948 was only $623.81 and for 1947, the additional tax liability was $5,229.76. These figures were arrived at without giving effect to any of the allowable deductions. Computation based upon the reduction in gross income of $19,000.00 to $20,000.00 would have wiped out all of these tax liabilities.

Upon the record as made in this case, it was incumbent on the Court below and upon this Court to hold, as a matter of law, that the gross income in 1949 should be reduced by $19,000.00 and the tax liabilities for the years re-computed on that basis and when so done, there would, as a matter of law, be no tax liability in any of the years in question.

The Court has overlooked the important fact that the 1949 return, which was used as a basis for the computation, was not signed by defendant or anyone on his behalf and there is not a scintilla of evidence that defendant was aware of its contents.

Hammond testified that he left the return with defendant by the documentary evidence and his own later testimony, and the testimony of the Revenue Agent, established without question that Hammond was mis-

taken. This evidence established that the original returns prepared by Hammond were obtained from Hammand by the Revenue Agent Menlow. He took photographic copies of the returns, being the copies in evidence, and later returned the returns to Hammond.

Revenue Agent Menlow testified: (Tr. 577)

"Q Did you see the originals from which these photostats were taken?

A Yes, sir.

Q And where did you obtain the originals from which those photostats were taken?

A *They were in the boxes or records we received from Mr. Hammond.*

Q Were those among the records that were turned over to you in either February, 1951, or at the end of the year, when you picked up the second batch of records?

A They were in the boxes."

Hammond testified: (Tr. 227-228)

"MR. MEAD: *These returns were furnished by you to the Government* for the purpose of taking these photostatic copies; is that correct?

A Yes."

In *United States v. O'Malley,* 131 F. Supp., 409, the Court granted a motion for judgment of acquittal. Emphasis was placed by the Court on the fact that the exculpatory evidence was developed in the Government's case upon cross-examination. The Court said:

> "Under such circumstances the evidence all adduced in the Government's case, falls far short of the substantial proof necessary to establish a total lack of cash resources on January 1, 1946."

If the evidence of over-statement of gross income in the 1949 return had been introduced in the first place

by defendant in the defendant's case, and the evidence depended upon the credibility and veracity of the witnesses, an issue of fact would be presented for consideration by the jury. But in the case at bar, the Government used the unsigned return prepared by the accountant as a starting point and the Government's own witness dissipated the evidentiary value of that return when the Government's witnesses testified that the return over-stated the income. That made the return an improper basis for computation. It created a defect or deficiency in the Government's case with respect to the issue of the existence of taxable income in that year (upon which the Government had the burden of proof) and the existence of a large loss deduction available for carry-back purposes.

II

Re Deductions

The Court erroneously indulges in speculation that the payments in cash for various operating expenses which were not taken as deductions in the returns, might have been paid with cash received from sales.

Neither the indictments, nor the bills of particulars, charge the failure to report any cash receipts from any source whatsoever.

The receipt and disposition of cash from sales was not made an issue in the case and defendant was not tried on any such charge.

This case is based upon an indictment implemented by bills of particulars which charge the failure to report

certain specific items of unreported income, each of which was represented by a check received by defendant, cashed by him and disbursed by him, and not upon unreported cash sales.

There is no evidence that any of the payments for the claimed allowable deductions came from cash received from sales. It is a surmise merely. The Court overlooked the important fact that this case is not predicated on the net worth theory or on the bank account theory.

Moreover, neither the indictment, nor the bills of particulars, charged defendant with the taking of unlawful deductions except the one item of $637.00 alleged to have been taken in 1947 (Bill of Particulars, Tr. of Rec. 10-11) and no attempt was made to establish that this deduction was unlawful or improper.

Upon these indictments and these bills of particulars, it is pure speculation to surmise that the cash payments made for itinerant laborers and other purposes came from unreported cash received from sales.

As to the year 1947, there is direct evidence by the witness Schmidt that the principal item of unreported income, $12,750.00, received from Church Grape Juice Co., and the smaller checks, were used, in fact, to pay the itinerant laborers. (See summary of evidence, page 34, Appellant's Opening Brief.) There is not a scintilla of evidence to the contrary or that would raise a doubt as to the truth of this testimony given by the Government's own witness. He gave this testimony on direct examination (Tr. 164-5) and on cross-examination (Tr. 188-9).

Defendant was entitled, as a matter of law, to take deductions for all business expenses regardless of the source of the funds with which the expenditures were paid.

The return for the year 1947, and the Government's experts, failed to give effect to the payment *by checks* drawn on the business account of the Nursery for State income taxes totaling *$6,187.50* which was the State tax liability for both partners. *These were not paid in cash.* There is in evidence, as part of the Government's case, the checks with which payment was made and the testimony of the payments. (Exh. 111, and Tr. 45, 604, 612-614, 703.) There certainly was no issue of fact to be submitted to the jury as to the State tax liability, its payment and that it constituted a proper allowable deduction which had not been taken.

If it was the Government's contention that the payments were made with funds derived from unreported taxable income, then the burden of proof was on the Government to establish that fact. The receipt of taxable income is a part of the Government's case which must be pleaded and established by evidence.

In *United States v. O'Malley,* 131 F. Supp., 409, the Court said:

> "The Government had the burden of proving that defendant's explanations were false in order to justify the inference that the alleged loans were in fact taxable income, United States v. Adonis, 3 Cir., 221 F. 2d 717."

Here, there was no charge in the indictment, or in the bills of particulars, that the defendant received tax-

able income *in cash*. The bills of particulars specify certain specific items which were received by checks from various sources, but it is not charged that he received in cash any unreported income.

While there is evidence that there were some cash sales made (not many) (Tr. 736), there is not a scintilla of evidence that any of it was used to pay the expenses involved in the claimed deductions established by the evidence.

III

Re Intent

The Court applied a basically erroneous principle covering the disposition of motions for judgment of acquittal. It is settled beyond question that

> "To sustain a finding of fact the circumstances proven must lead to the conclusion with reasonable certainty and must be of such probative force as to create the basis for a legal inference and not mere suspicion. Circumstantial evidence, *even in a civil case, is not sufficient to establish a conclusion or where they give equal support to inconsistent conclusions.*" (Wesson v. United States, 172 F. 2d, 931; Eighth Cir.) (Emphasis supplied.)

In *United States v. Kelley,* 119 F. Supp., 217, the Court held:

> "As in all criminal cases, there must be substantial evidence of facts consistent with guilt and inconsistent with every reasonable hypothesis of innocence of the crime for which convicted. Hammond v. United States, supra; United States v. McCarthy, 7 Cir., 1952, 196 F. 2d 616; Johnson v. United States, 8 Cir., 1952, 195 F. 2d 673; Strickland v.

United States, 5 Cir., 1946, 155 F. 2d, 167; United States v. Laffman, 3 Cir., 1945, 152 F. 2d 393; Scott v. United States, 10 Cir., 1944, 145 F. 2d 405, certiorari denied 323 U.S. 801, 65 S. Ct. 561, 89 L. Ed. 639; United States v. Tatcher, 3 Cir., 1942, 131 F. 2d 1002. 'It is still the law that there can be no conviction of crime on circumstantial evidence unless the only possible inference to be derived from it is that of guilt. There must be evidence which forecloses and makes impossible any other conclusion.' Maryland & Virginia Milk Producers Ass'n v. United States, 1951, 90 U.S. App. D.C. 14, 23, 1953 F. 2d, 907, 917."

We respectfully submit that the Court did not give effect to the principles set forth in these cases.

The Court, in the case at bar, starts with the assumption that evidence of intent "necessarily must be circumstantial." It then summarizes certain circumstances and it comes to the conclusion that the circumstances, designed to establish concealment, merely established "concealment from his wife rather than the Treasury Department". The Court also concluded that the evidence of the failure to take the deductions in the years in question for "large items of business expense" indicates that Elwert was "not tax conscious" and "tends to negate any intention to evade taxes". The Court went on to point out the reason for Elwert's maintenance of the bank accounts in fictitious names and it found that this was induced by the difficulties with his wife and was not brought about by any intent to evade tax liability. The Court then concludes that there exists a reasonable hypothesis of innocence.

We have, therefore, conclusions by the Court of the existence of the basic elements which establish lack of intent.

Nevertheless, the Court sustains the conviction because there were in evidence some circumstances from which a jury could have drawn an inference contrary to that of innocence. This is diametrically opposed to the rule referred to above.

In *Pevely Dairy Co. v. United States,* 178 F. 2d, 363, (Eighth Cir.) the Court said:

> "In Read v. United States, 8 Cir., 42 F. 2d 636, 638, which was a criminal case, this court, in an opinion by the late Judge Kenyon, said: 'The law applicable to the first proposition (the question of the sufficiency of the evidence) is well settled in this circuit. In Salinger v. United States, 8 Cir., 23 F. 2d 48, 52, this court said: 'Unless there is substantial evidence of facts which *exclude every other hypothesis but that of guilt*, it is the duty of the trial judge to instruct the jury to return a verdict for the accused, and, *where all the evidence is as consistent with innocence as with guilt, it is the duty of this court to reverse a judgment against the accused.*' ' " (Emphasis supplied.)

The only circumstances which the Court points to as tending to establish an inference of guilt, is the statement made by the witness Cook that he asked defendant

> "What other transactions have you had for the year." (Tr. 48.)

But this statement, general in character and not directed to any specific matter, did not involve merely a failure to report additional gross income. He used the term "transactions" and "transactions" involve not only

receipt of income, but also involves expenditures for business operations which would be allowable deductions. The import of that statement is that Elwert failed to inform him that he had made many disbursements for business expenses which would be allowable deductions, as well as the failure to inform him of additional income. If there had been merely a failure to disclose additional income, perhaps an adverse inference could be drawn. But there was a failure to disclose additional expense as well as income and, therefore, the statement relied on to support an adverse inference lacks probative value as evidence of an intent to evade the tax.

The statement is consistent only with the conclusion that Elwert was careless or thoughtless or lacked recollection, both as to additional items of income and additional items of deductible expense.

In this respect, Elwert is subject to no more criticism than the accountant Cook himself for he, too, failed to recall that checks totaling $6,187.50 were drawn on the firm's bank account and paid to the Oregon State Tax Commission in 1947 in payment of the 1946 tax which were clearly allowable deductions. Yet, he omitted to take this deduction in making the 1947 return.

The allowable deductions which defendant failed to take in the returns are so extensive in amount and are of such character that it must be said, as a matter of law, that defendant could not have, and did not have, the intent to evade his income tax liability. The failure to take the deductions is consistent only with the con-

clusions that defendant was not "tax conscious" as the Court has already found. The conclusion is inevitable that the defendant merely went about the business of conducting the partnership operations without any thought or regard for tax consequences, either with respect to receipts or disbursements, to such an extent that even when the consequences of his failure to keep a record of his cash expenditures tax-wise was directly called to his attention and impressed upon him by the accountant and was told that it would result in loss to him, he, nevertheless, neglected to keep records of such expenditures. It is inconceivable that a farmer, operating as defendant did, as described by both accountants, could have entertained the intent to evade taxes. The evidence merely established that the defendant was one of a class who cannot reconcile themselves to keeping of records.

Another factor that strongly mitigates against the existence of the criminal intent, is the infinitesimal amount of deficiency in taxes determined by the Government's experts. As already pointed out, in 1949 the *total* tax liability for the year was only $657.08. In 1948, the tax d*eficiency*, as established by the Government's experts, was only in excess of $623.81. Certainly, in these two years the amounts are infinitesimal in relation to the volume of the business transacted and it taxes credulity to say that defendant entertained the intention to cheat the Government out of these two small amounts under the conditions disclosed by the record.

CONCLUSION

We sincerely believe that the conviction of the defendant upon the record in this case is a grave miscarriage of justice. The decision in this case, in effect, removes the element of specific intent to evade as a basic requirement to warrant conviction. It subjects every taxpayer to the hazard of conviction because of mistakes, ignorance, or negligence, in the conduct of his business affairs. It permits the submission of a case to a jury upon evidence of a very nebulous general statement in the face of the overwhelming evidence in the Government's case which established lack of criminal intent.

We earnestly and sincerely urge upon the Court a reconsideration of the record in the light of these observations and the points presented by our former briefs.

We believe that the questions involved warrant submission of the case to the entire Court sitting *en banc* and that upon a re-consideration, the judgment of conviction should be reversed with directions to enter a judgment of acquittal.

Respectfully submitted,

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